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No. 17902

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In the Matter of McDANIEL'S MARKETS,
a California corporation,

Bankrupt,

IRVING I. BASS, Trustee,

Petitioner,

vs.

RIALTO PUBLISHING COMPANY, and
TRIAD NEWSPAPERS, INC.,

Appellants.

APPELLANTS' OPENING BRIEF

APPEAL FROM
UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

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APPELLANTS' OPENING BRIEF

I.

STATEMENTS OF FACTS AND PLEADINGS.

On June 22, 1961, both appellants filed actions in the San Bernardino Municipal Court against McDaniel's Markets for sums due them for newspaper advertising. On the same date, both appellants attached cash at one of the markets. On July 14, 1961, Triad Newspapers, Inc., having entered a default judgment, obtained $1,666.69 from the attached funds by writ of execution. On July 19,

1961, Rialto Publishing Company likewise obtained $2,550.05 from the attached funds by execution levy. On September 15, 1961, less than three months after the attachment, an involuntary petition in bankruptcy was filed on behalf of McDaniel's Markets.

A PETITION FOR ORDER TO SHOW CAUSE DECLARING LIEN BY ATTACHMENT NULL AND VOID was filed on or about March 14, 1962, and the appellants were served with the order to show cause. This petition did not allege that at the time appellants obtained their lien, they had reasonable cause to believe the bankrupt was insolvent. Both appellants filed answers asserting that the trustee could not recover without proving this element since the liens had been satisfied prior to the initiation of bankruptcy proceedings. Rialto Publishing Company also alleged that on June 22, 1961 it did not have reasonable cause to believe the debtor was insolvent. The trustee filed amended petitions alleging upon information and belief "that at the time the lien was obtained, to-wit, on the 22nd day of June, 1961, the said McDaniel's Markets then was, and now is, insolvent and the said respondent did have knowledge of the insolvency of the said McDaniel's Markets; that said lien obtained by said attachment and subsequent execution was filed within four months before the filing of the Petition in Bankruptcy herein and is therefore null and void". (Italics mine).

While the word "preference" was not used, the amended petition sought to recover the funds under §60 of the Bankruptcy Act rather than §67a. Triad Newspapers, Inc. filed an answer to the amended petition; at the hearing before the Honorable Russell

B. Seymour, referee, the parties stipulated that the answer filed by Rialto Publishing Company to the original petition should be deemed an answer to the amended petition. The parties also stipulated that the bankrupt was actually insolvent on June 22, 1961, and that the court had jurisdiction to decide the matter at that time and place. The District Court had jurisdiction to decide the matter pursuant to §23b of the Bankruptcy Act. The case of McDonald v. Plymouth County Trust Co., 286 US 263, authorizes a referee in a bankruptcy matter to set aside a preference in a summary proceeding where the transferee acquiesces in said determination.

Appellants do not object to any phase of the proceedings, nor for that matter do they object to the findings of fact. The purpose in mentioning the original and amended petitions and in quoting from the amended petition is to show that when the amended petition was filed, all parties were under the impression that the issue was whether on June 22, 1961, at the time of the attachment levy appellants had reasonable cause to believe that the bankrupt was insolvent. That issue was decided in appellants' favor.

According to paragraphs III and IV of the findings of fact, on June 22, 1961, at the time of the attachments, neither appellant had reasonable cause to believe that the bankrupt was insolvent; at the time of the execution levy they did have reasonable cause to believe the bankrupt was insolvent. However, the conclusions of law, paragraph II, stated that payment of the attached funds to appellants under the writ of execution constituted a voidable preference. Appellants were both ordered to pay to the trustee the sums

received. Both appellants filed Petitions for Review, and the Honorable Leon J. Yankwich, judge of the District Court, confirmed and adopted the findings of fact and conclusions of law of the Honorable Russell B. Seymour and also ordered appellants to repay the sums received by attachment and execution with interest from the date of the referee's order.

II.

STATEMENTS OF CONTENTIONS AND SPECIFICATION OF ERRORS.

Appellants contend that "the transfer was made" when the money was first attached rather than later when it was received by execution levy. Consequently they contend that at the time the transfer was made, they did not have reasonable cause to believe that the debtor (now the bankrupt) was insolvent. Appellants have raised this contention by oral agreement and written points and authorities submitted both to the Honorable Russell B. Seymour, referee, and to the Honorable Leon J. Yankwich, judge. Appellants do not object to any phase of the proceedings nor to the findings of fact. They only find fault with the conclusion of law and order.

III.

SUMMARY OF ARGUMENT.

Appellants can find no reported case where this precise issue

was decided. However, §60(2) of the Bankruptcy Act provides that a transfer is deemed to have been made when it becomes so far perfected that no subsequent lien could become superior. When an attachment levy is made, the lien is so far perfected that no subsequent lien can prevail, according to state law. There are reported cases involving similar situations in which the date of the attachment levy was deemed the date the lien was obtained -- despite the fact that the attaching plaintiff had to take further steps to enjoy the benefit of his lien and despite the fact that he risked losing his lien through an adverse judgment. The best example is the situation where the creditor attaches more than four months prior to bankruptcy and obtains the money by execution less than four months prior to bankruptcy. Several cases have held that the trustee cannot recover this money, and it makes no difference whether the creditor knew the debtor was insolvent. Why isn't the payment less than four months prior to bankruptcy considered a voidable preference? Because the lien has already been perfected, and the creditor has attained the status of a secured creditor.

IV.

ARGUMENT WITH POINTS AND AUTHORITIES.

The trustee now contends that the transfer, which he seeks to set aside as a voidable preference, took place when appellants obtained the attached funds by execution levy. Appellants contend

that the transfer constituting a preference (but not a voidable preference because of lack of knowledge of the debtor's insolvency) took place at the time of the attachment levy. Before arguing the matter further, it is necessary to consider whether giving or suffering a lien can constitute a preference or whether the transfer or preference is only completed when the lien is satisfied and the creditor receives the money or property. According to Remington on Bankruptcy (Vol. 4, p. 263), "Liens obtained by legal or equitable process or proceeding, such as attachment, judgment and execution liens and those imposed by decree in equity, may give rise to voidable preferences under Sec. 60, though they are more specifically covered by Sec. 67(a) of the Act".

The pertinent provisions of §60 of the Bankruptcy Act are as follows:

> "(2) For the purposes of subdivision a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee . . .
>
> "(4) A lien obtainable by legal or equitable proceedings within the meaning of paragraph (2) is a lien arising in ordinary course of such proceedings upon the entry or docketing of a judgment or decree, or upon attachment, garnishment, execution, or like

process, whether before, upon, or after judgment or decree and whether before or upon levy. It does not include liens which under applicable law are given a special priority over liens which are prior in time."

According to Remington (4 Remington on Bankruptcy 289), "The date of making a payment or a transfer is usually a mere question of fact. Insofar as there is a question of law as to when the transaction was completed state law governs" (Citing McKenzie v. Irving Trust Co., 323 US 365). The question then becomes: According to California law, when is the lien on the property perfected so that no subsequent lien could become superior?

Appellants contend that the lien became so perfected when the attachment levies were made. No subsequent attachment would have prevailed because . . .

"While the statutes specifically prescribe the effective date of the lien of an attachment on real property and provide for a cessation of the lien in the event of failure of the officer to complete the execution writ within a specified time, they are silent as to the inception of the lien in the case of personal property. In the absence of statute, it is the general rule that an attachment operates as a lien from the time of the levy." (Citing Am Jur Attachment & Garnishment §825).

6 Cal Jur 2d 40, §131.

"Generally speaking, the rule of priority in time governs where there are several conflicting attachments. In the case of several writs placed in the hands of the same officer, priority is determined by the time they are received, although where the writs are received and levied by different officers, priority rests upon the order of the several levies."

6 Cal. Jur. 2d 47;

Whitney v. Butterfield, 13 Cal. 335.

Actually, appellants believe that the rule just cited by Cal. Jur. 2d is inaccurate in stating that when several writs are placed in the hands of the same officer, priority is determined by the time they are received. The true rule is that the first levy prevails. For example, in the case cited, Whitney v. Butterfield, the sheriff received a writ of attachment at around 10:00 p. m. on a Sunday night, and his deputy received another writ at 1:00 a. m. the next morning! The deputy didn't know the sheriff had received a writ earlier (the Court considered that he had received it at the stroke of midnight since Sunday didn't count), and the deputy levied. The action was against the sheriff for not levying first. The court considered the sheriff and his deputy as one person, but it held that the few hours' delay of the sheriff and failure to communicate with his deputy were not unreasonable; otherwise the sheriff would have been liable to the plaintiff who had first delivered the writ to him. However, the prior levy still had priority over the first!

The court followed the same rule in Johnson v. Gorham, 6 Cal. 195, except that execution levies were involved. Still the first levy prevailed, even when the levying officer failed to levy on the first execution received.

The rule seems clear-cut that no subsequent levy of attachment or execution could prevail against appellants' levies. Could any other type of lien have prevailed? Not according to 6 Cal. Jur. 2d 48 and Scrivener v. Dietz, 68 Cal. 1.

> "The rule that, generally speaking, different liens upon the same property have priority according to the time of their creation is applicable as between attachment and other liens."

This case involved a mortgage (apparently unrecorded) and an attachment. This is an odd case since an attachment or execution is only supposed to reach the debtor's interest, whatever it may be, but the case stands for the proposition just stated.

Consequently the transfer was completed to appellants when the attachments were levied upon. Since they did not then have the necessary knowledge or belief pertaining to the debtor's insolvency, this was not a voidable preference.

The trustee has argued that the attachments were voidable since they occurred within four months of bankruptcy. His argument is based upon a footnote in Collier on Bankruptcy (Vol. 4, p. 112, footnote 11) which says:

"On the other hand if the guarnishee (sic) lien was obtained when the debtor was insolvent and the other elements of a preferential transfer existed, but the transfer was not voidable because the creditor did not then have reasonable cause to believe his debtor to be insolvent, does subsequent acceptance of payment, in satisfaction of the lien, at a time when the creditor has reasonable cause to believe his debtor to be insolvent, constitute a preference? The correct answer is believed to be 'yes'. Here it will be noted that the garnishee lien is not voidable under §60b but is voidable under §67a since the creditor's knowledge of insolvency is immaterial. Acceptance of payment by the creditor is a transfer by the debtor of his property within the terms of §60 and 1(30), and since it is to obtain satisfaction of a lien voidable under §67a, the payment depletes the estate, and, the other elements of a voidable preference then being present, the creditor-transferee should be compelled to disgorge. See Adler v. Greenfield (C. C. A. 2d Cir.), 31 Am. B. R. (N. S.) 439, 83 F. 2d 955."

In the first place, this is only the opinion of a writer, not a court decision.

In the second place, the case cited, Adler v. Greenfield,

does not support this opinion at all, since there was no attachment and the creditor had no lien until he obtained a writ of execution two months prior bankruptcy. Apparently the other elements of our case were not present since there was no contention that at the time of the transfer (which had to be at the time of the execution levy since there was no other levy or lien) the creditor had no knowledge of the debtor's insolvency.

In the third place, the reasoning for this opinion is based on the assumption that the attachment lien was voidable under §67a. However, that is not true. Section 67a does not cover the case of a lien which, though obtained while the bankrupt is insolvent and within four months of bankruptcy, is satisfied prior to the filing of the petition initiating proceedings under the Bankruptcy Act.

Remington on Bankruptcy, Vol. 4, §1680, §1611;
Kaufman v. Easter Baking Co., 53 F. Supp. 364,
affd. 146 F2d 826.

Quoting from this section,

"Although most liens obtained by legal proceedings against property of a bankrupt while he is insolvent and within 4 months of bankruptcy are now open to attack under §60 as well as §67(a), rarely, if ever, is any advantage to be gained by basing the attack on the former instead of the latter. The factors that make a lien void under §67(a), notably insolvency of the debtor-bankrupt when the

lien was obtained and obtaining the lien within a 4-month period are involved in either case. But in addition, to make out a preference voidable under §60(b), knowledge of the transferee or his agent of the debtor's insolvency must be shown, as well as all the other elements of a voidable preference. In one situation, however, §60 can be invoked to advantage. Section 67(a) does not cover the case of a lien which, though obtained while the debtor-bankrupt is insolvent and within 4 months of bankruptcy, is satisfied prior to filing the petition initiating proceedings under the Bankruptcy Act. The sheriff having seized cash or liquidating the property and turned the proceeds over to the attaching or execution on creditor, the lien has ceased to exist and §67(a) does not provide for reopening the satisfaction. But the funds in the hands of the creditor can still be considered a payment or transfer on antecedent indebtedness and recovered under §60(b) by meeting the §60 requirements. If the lien antedates bankruptcy by more than 4 months, however, the payment over in satisfaction of it cannot be reached even under §60, as the preference is considered to revert back to obtaining of the lien as part of an integrated transaction protected by §67(a)." (Italics mine).

The situation is as follows: The trustee cannot recover under §67a, voiding a lien, because at the time of the bankruptcy, the lien no longer exists. The trustee argues: If the petition in bankruptcy had been filed while the property was still under attachment, the attachment could have been voided. Consequently, the attachment was voidable even though the petition was not filed in time, and since the attachment was voidable, payment under the execution was a voidable preference.

The answer to this argument is that the attachments were not voidable because the petition was not filed while the attachment liens were still in existence.

By analogy, consider two similar situations:

It is an act of bankruptcy to suffer or permit, while insolvent, a lien upon one's property through legal proceedings and not to vacate or discharge such lien within thirty days from the date thereof . . . In order to take advantage of this act of bankruptcy, a petition must be filed within four months thereafter. Section 147 of Remington on Bankruptcy (Vol. 1, pages 234, 235) states:

> "A lien obtained more than four months before the petition is filed is not to be disrupted, and failure to remove it cannot serve as an act of bankruptcy, notwithstanding no steps have been taken to enforce or foreclose the lien until within four months. In other words, the date of obtaining the lien fixes the four months' limitation on time to file the petition, not the failure to remove the

lien or absence or presence of enforcement proceedings . . . . Where the first lien arises by levy of execution, it is the date of such levy which starts the 4-months' period . . . . If the lien was obtained by attachment, the lien goes back to the date of levy of the attachment and does not arise with the judgment." (Italics mine).

When an attachment is made more than four months prior to bankruptcy and execution within four months, the lien is considered as obtained when the attachment is made (notwithstanding the fact that the lien obtained is inchoate only, and subject to be lost if the suit wherein it is obtained does not result in the plaintiff's favor).

Yumet & Co. v. Delgado, 243 F. 519.

Liens obtained by legal proceedings relate back to when they are first effectively obtained, which may be by attachment, garnishment, a restraining order, or some other such step at or near the commencement of the suit, and delay in obtaining an adjudication or realizing upon such a lien will not leave it open to attack as a voidable preference if it was obtained prior to the four-month period.

Kaufman v. Eastern Baking Co., 53 F. Supp. 364,
4 Remington 291.

In this situation (attachment more than four months prior to bankruptcy), the attachment cannot be set aside because of the

time period; in our case we contend the attachment cannot be set aside because of lack of knowledge of insolvency. Otherwise, the situations are identical. In either case, if the petition initiating bankruptcy proceedings were filed in time -- before the satisfaction of the lien by execution -- the attachment could be set aside under the provisions of §67(a) of the Bankruptcy Act. But that does not mean that the attachment is considered voidable. If that were the test, all attachments would be considered voidable. If the trustee's argument were to prevail, and to be carried to its logical conclusion, the creditor would be deemed to receive a voidable preference when he levied an execution, even though the attachment was more than four months prior to bankruptcy. The attachment would be voidable because if the petition in bankruptcy had been filed sooner, the attachment could have been set aside! We know from the last two cases cited that the courts have always rejected this concept of a voidable lien. Appellants obtained valid liens, not voidable liens, on June 22, 1961, and there was nothing improper in their enforcing these liens and collecting their money at a later date when they knew of the debtor's insolvency.

Respectfully submitted,

/s/ Marshall Miles

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